JUNE 2022 PERFORMANCE

TOTAL NET RETURN

PERIOD	FUND RETURN
1 Month	- 3.52%*
Life to date	-3.98%*

*Post management, performance and entry fees. Past performance is not indicative of future performance.

The Fort Stable Fund generated a return of -3.52% for the month of June 2022. We continued to maintain our long ETH position at a little under 10% of AUM as we awaited any potential fallout from the Terra/Luna collapse. We were able to capture about 80bp of value from the sale of ETH put options during the month as forced liquidations pushed the price of ETH under $900.

ETH ended the month down 47% at $1059. Our yield-based strategies earned 0.10% for the month. DeFi yields continued to remain under pressure as investors sought the safe haven, fiat backed stablecoins such as USDC. Life to date the Fund has returned -3.98%.

It didn't take long for the contagion of the Terra/Luna collapse to spread across crypto markets. Total crypto currency market capitalisation declined $400bn in June, down 30% from $1,300bn at the end of May 2022. We will give a summary of the key events which transpired in June. Every couple of days we heard a new story about an insolvency, loan liquidation, or fund blow-up. While not all the details are known at this stage, what we do know is that these events took place in the world of centralised finance (CeFi) while decentralised finance (DeFi) continued to work as it was designed to do. Before we begin, we should acknowledge that Terra/Luna was a DeFi protocol but with a flawed design which was known and had been pointed out as far back as 2018. (We covered the Terra/Luna collapse in a previous research note).

The first large crypto lender to run into difficulty and freeze depositors' assets was Celsius Network LLC. According to the Wall Street Journal:

"Celsius Network LLC became a cryptocurrency lending giant on a pitch that it was less risky than a bank with better returns for customers.

But investor documents show the lender carried far more risk than a traditional bank.

The lender issued numerous large loans backed by little collateral, according to Celsius investor documents from 2021 reviewed by The Wall Street Journal. The documents show that Celsius had little cushion in the event of a downturn, and made investments that would be difficult to quickly unwind if customers raced to withdraw their money. Celsius didn't respond to requests for comment from the Journal.

Celsius had $19 billion of assets and roughly $1 billion of equity as of last summer, before it raised new funds, according to Celsius investor documents from 2021 reviewed by the Journal. The median assets-to-equity ratio for all the North American banks in the S&P 1500 Composite index was about 9:1, or about half that of Celsius, according to data from FactSet.

For banks, that ratio is of great importance: Regulators look at it as an indicator of risk. For unregulated companies like Celsius, the ratio of 19-1 is particularly high given that some of its assets were investments in

the extremely volatile crypto sector, said Eric Budish, an economist at the University of Chicago's business school who studies cryptocurrencies. Large banks often have ratios near Celsius's, but they hold much more stable assets and have access to central-bank loans for ready cash.

"It's just a risky structure," Mr. Budish said of Celsius. "It strikes me as diversified as the same way that portfolios of mortgages were diversified in 2006," referring to a feature of the 2008 financial crisis. "It was all housing—here it's all crypto. "

The five-year-old company is now one of the highest-profile crypto firms fighting for survival, as the sector is struggling amid a plunge in cryptocurrency values. Last week, Celsius tapped consultants to advise on a potential bankruptcy filing, the Journal previously reported. That followed the company's June 12 freeze on all withdrawals, citing "extreme market conditions."

https://www.wsj.com/articles/behind-the-celsius-sales-pitch-was-a-crypto-firm-built-on-risk-11656498142

In the last few years, we've seen the rise of so-called Centralized DeFi-companies that custody/manage crypto on behalf of investors.

Celsius takes your money/crypto, promises you a fixed interest rate, and then puts it on-chain to use in DeFi to earn a yield. Celsius, at its peak, managed somewhere in the order of $10 billion dollars.

While they advertise their services like that of a bank, the service is almost more like a hedge fund or asset manager—these strategies have some risk involved and require active management. Celsius was (likely) exposed to two different events that lead to their insolvency:

1. As Luna collapsed, Celsius, who promised strong rates on stablecoins, was exposed to the collapse by holding (maybe up to $500m) in $UST

2. Celsius promised 6-8% in interest, with a lot of it likely earned from staking rewards on the Proof-of-stake Ethereum Beacon chain. Since $ETH on the Ethereum Beacon chain is completely locked up, it was impossible for the project to liquidate.

While it's likely that Celsius was still solvent post $UST depeg, as markets were rocked, a liquid staking Ethereum derivative called stETH began to trade at more and more of a discount. While stETH typically trades at close to a 1-to-1 ratio, large scale redemptions pulled that ratio down to about .9. This was cyclical for Celsius (more selling lowered price), but also pulled down the price for others.

The next significant news to emerge was that one of the larger and most prolific crypto hedge funds, Three Arrows Capital (3AC) was not returning calls from investors and was failing to meet margin calls.

3AC was founded in 2012 by Su Zhu and Kyle Davies, former TradFi traders who were successful at equity derivative arbitrage and eventually made their way into crypto where they initially were successfully exploiting arbitrage opportunities. They were early backers of some successful crypto projects which gave them increased influence in the space. Three Arrows' assets under management were estimated to be about $10 billion in March, according to blockchain analytics firm Nansen. Davies told the Wall Street Journal earlier last month that it had roughly $3 billion in assets under management in April before crypto markets crashed.

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However, it appears that over time they increased their risk taking through large, leveraged directional bets. Davies said 3AC invested over $200 million in LUNA tokens as part of a $1 billion raise by the Luna Foundation Guard in February, an amount that is now essentially worthless since the Terra ecosystem imploded in mid-May. “The Terra-Luna situation caught us very much off guard,” Davies told the WSJ.

3AC had borrowed from many crypto lenders including BlockFi, Genesis, Babel Finance, and crypto broker Voyager digital.

BlockFi first liquidated 3AC in mid-June, saying a large client failed to meet obligations on an overcollateralized margin loan. Subsequently, BlockFi initiated layoffs for 20% of its employees and moved to the crypto exchange FTX for a USD 250 million revolving credit facility.

Voyager Digital secured a loan (USD 200 million and 15,000 BTC) from Alameda Research to safeguard their customers’ assets in the current bear market. As they announced the company’s total of USD 720 million exposure to 3AC, the share price went down by 60%, cutting the daily withdrawal limit to USD 10,000 from USD 25,000. Soon after, the company issued a notice of default to 3AC after the hedge fund failed to make the required payments on its loan.

These announcements obviously caused concern amongst depositors on these platforms that their funds may be at risk. As many investors tried to withdraw at the same time, the platforms were unable to meet demand and in the case of Celsius and Voyager, they suspended or limited withdrawals.

According to the Financial Times on Saturday 2nd July

“Three Arrows Capital has filed for bankruptcy in the US, highlighting the scale and reach of the prominent crypto investment firm’s borrowings across the industry before it collapsed into liquidation this week. The Chapter 15 bankruptcy filing in Manhattan federal court late on Friday came just days after Three Arrows was pushed into liquidation in the British Virgin Islands, following claims that it failed to pay $80mn it owed to digital asset exchange Deribit.”

https://on.ft.com/3nADLSE

While we will have to wait some time for these bankruptcy proceedings to play out, it’s instructive to understand broadly how these CeFi lenders operated and then compare that with the performance of DeFi protocols during the month.

The CeFi lenders we able to pay depositors significantly higher rates of interest than what traditional banks pay on deposits because they could on-lend those funds at even higher rates of interest to crypto funds and trading firms. These funds and trading firms make money from arbitrage and market making activities on crypto exchanges to support paying those higher interest rates. However, it’s a capital-intensive business so being able to borrow more with less collateral is the only way to scale the business.

The CeFi lenders such as Celsius rolled out innovative mobile Apps to make it easier for retail investors to deposit their money without having to manage the complexities of using DeFi protocols themselves.

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So as deposits quickly grew, the CeFi lenders had more funds to lend. And probably over time, their lending standards became less stringent as they needed to lend out the funds they were taking in.

The CeFi lenders didn't face the same regulatory constraints that regulated financial institutions face. Their balance sheets were not open to public scrutiny. So, it wasn't until the "bank run" began that it became apparent that some of these firms might have solvency issues.

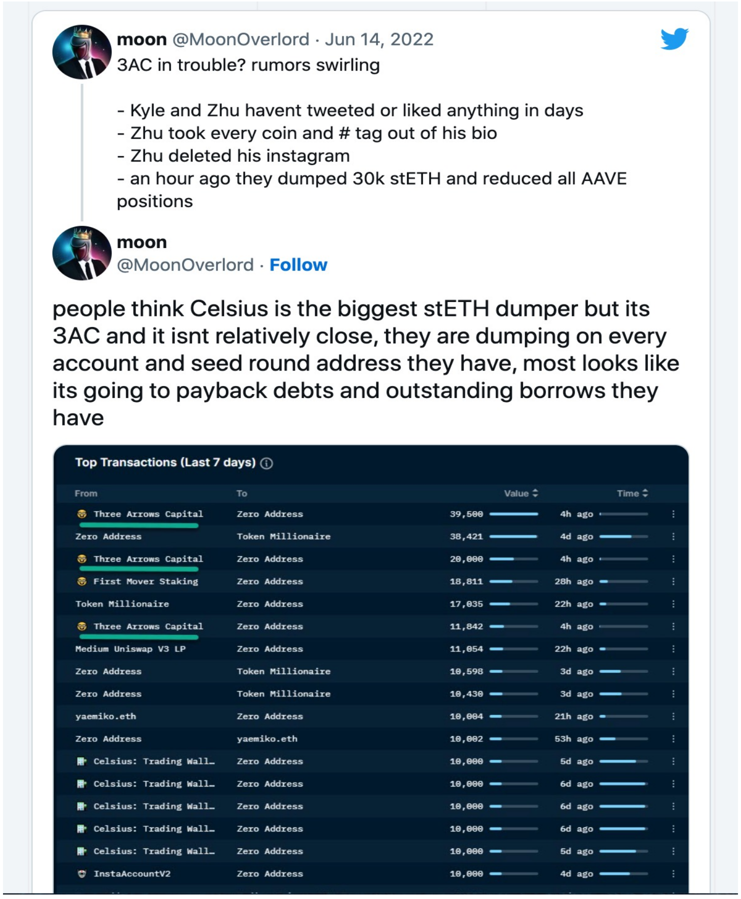
If we take a look at the main DeFi protocols which were used by firms such as 3AC to borrow funds, we can get a clear idea of some of the key differences between CeFi and DeFi.

The key features DeFi lending has which CeFi usually doesn't are transparency and rules-based lending. While we don't always know who the borrowing entity is just by looking at a blockchain address, there are several blockchain analytics companies which have been able to associate specific addresses with known prominent crypto companies.

The smart contracts used in DeFi lending and borrowing determine how much collateral must be held against a loan. And if the value of that collateral falls below a certain level, the collateral will be progressively sold to reduce the size of the loan to bring it back to the required threshold. Borrowers face significant liquidation penalties (5%+ on AAVE depending on the asset*) which incentivizes them to either top up collateral or pay down the loan before liquidation happens.

https://docs.aave.com/risk/asset-risk/risk-parameters

Here are some examples of how this was playing out in real time around the middle of June as an Ethereum address believed to be associated with 3AC had to sell some stETH to pay down debt on AAVE to avoid being liquidated.



moon @MoonOverlord · Jun 14, 2022
3AC in trouble? rumors swirling

- Kyle and Zhu havent tweeted or liked anything in days
- Zhu took every coin and # tag out of his bio
- Zhu deleted his instagram
- an hour ago they dumped 30k stETH and reduced all AAVE positions

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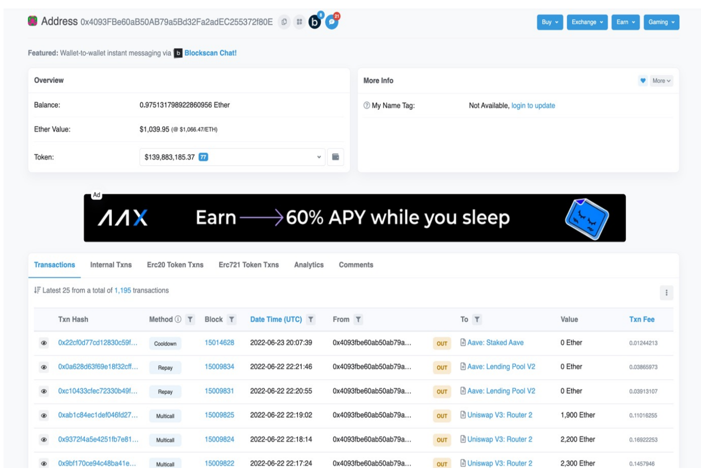
people think Celsius is the biggest stETH dumper but its 3AC and it isnt relatively close, they are dumping on every account and seed round address they have, most looks like its going to payback debts and outstanding borrows they have

Top Transactions (Last 7 days)

From	To	Value	Time
Three Arrows Capital	Zero Address	39,500	4h ago
Zero Address	Token Millionaire	38,421	4d ago
Three Arrows Capital	Zero Address	20,000	4h ago
First Mover Staking	Zero Address	18,811	28h ago
Token Millionaire	Zero Address	17,035	22h ago
Three Arrows Capital	Zero Address	11,842	4h ago
Medium Uniswap V3 LP	Zero Address	11,054	22h ago
Zero Address	Token Millionaire	10,598	3d ago
Zero Address	Token Millionaire	10,430	3d ago
yaemiko.eth	Zero Address	10,004	21h ago
Zero Address	yaemiko.eth	10,002	53h ago
Celsius: Trading Wall…	Zero Address	10,000	5d ago
Celsius: Trading Wall…	Zero Address	10,000	6d ago
Celsius: Trading Wall…	Zero Address	10,000	6d ago
Celsius: Trading Wall…	Zero Address	10,000	6d ago
Celsius: Trading Wall…	Zero Address	10,000	5d ago
InstaAccountV2	Zero Address	10,000	4d ago



Address 0x4093FBe60aB50AB79a5Bd32Fa2adEC255372f80E
Buy Exchange Earn Gaming
Featured: Wallet-to-wallet instant messaging via Blockscan Chat!

Overview
Balance: 0.975131798922860956 Ether
Ether Value: $1,039.95 (@ $1,066.47/ETH)
Token: $139,883,185.37 77

More Info
My Name Tag: Not Available, login to update

Transactions | Internal Txns | Erc20 Token Txns | Erc721 Token Txns | Analytics | Comments

Latest 25 from a total of 1,195 transactions

Txn Hash	Method	Block	Date Time (UTC)	From		To	Value	Txn Fee
0x22cf0d77cd12830c59f…	Cooldown	15014628	2022-06-23 20:07:39	0x4093fbe60ab50ab79a…	OUT	Aave: Staked Aave	0 Ether	0.01244213
0x0a628d63f69e18f32cff…	Repay	15009834	2022-06-22 22:21:46	0x4093fbe60ab50ab79a…	OUT	Aave: Lending Pool V2	0 Ether	0.03865973
0xc10433cfec72330b49f…	Repay	15009831	2022-06-22 22:20:55	0x4093fbe60ab50ab79a…	OUT	Aave: Lending Pool V2	0 Ether	0.03913107
0xab1c84ec1def046fd27…	Multicall	15009825	2022-06-22 22:19:02	0x4093fbe60ab50ab79a…	OUT	Uniswap V3: Router 2	1,900 Ether	0.11016255
0x9372f4a5e4251fb7e81…	Multicall	15009824	2022-06-22 22:18:14	0x4093fbe60ab50ab79a…	OUT	Uniswap V3: Router 2	2,200 Ether	0.16922253
0x9bf170ce94c48ba41e…	Multicall	15009822	2022-06-22 22:17:24	0x4093fbe60ab50ab79a…	OUT	Uniswap V3: Router 2	2,300 Ether	0.1457946

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Maker Dao, the protocol used to create the stablecoin, Dai, has online, real time monitors showing the health of all the Collateralized Debt Positions (CDPs).

https://maker.blockanalitica.com/

This transparency doesn't come without a cost. Open markets can be cruel. Market participants knew the levels for ETH and BTC which will force the protocols to have to sell indiscriminately in order to make sure its lenders don't lose money. This caused a lot of volatility during the month and a negative cascading effect on prices which will take some time for asset prices to hopefully recover.

But thanks to conservative margin requirements stipulated by the major DeFi protocols (AAVE, Compound, Maker Dao) these major lending protocols survived. Withdrawals were not halted, new loans continued to be issued and there was no downtime.

By removing trust from the system and providing a high level of transparency, DeFi certainly appears to have performed better than many of these centralised lenders.

The themes that run through all of the above are that without regulation individuals, both nefarious and incompetent, will take risks that are unsound. There is regulation, of a sort, inside DeFi that is, code-based rules, that were adhered to and performed well. The problems that the markets have faced emanated almost exclusively from the CeFi part of the ecosystem where the rules either weren't clear, unenforced, or outright ignored. One of our themes that we have been committed to is the creation of a robust regulatory approach. The events of the last few months will no doubt speed the engagement from the regulators, which in the long run will be a positive, allowing for greater participation and more certainty. In the short run however, uncertainty is likely to remain a headwind. DeFi still has many problems to solve including developing more real-world lending use cases however June 2022 has demonstrated the robustness of the technology. The system worked without the need for expensive, lengthy litigation and allowed the market to clear its risk in a volatile yet orderly fashion.

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